

PENNZOIL OIL & GAS, INC.

IBLA 84-816

Decided June 8, 1989

Appeal from a decision of the Acting Director, Minerals Management Service, requiring the payment of additional royalties on crude oil. MMS-81-0028-OCS.

Affirmed.

1. Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: Oil and Gas Leases

Under 30 CFR 250.64, the value of production of crude oil produced from a lease issued under the Outer Continental Shelf Lands Act for the purposes of computing royalties may not be less than "gross proceeds accruing to the lessee from the disposition of the produced substances." MMS properly determined that "gross proceeds" includes "tertiary incentive revenue" under 10 CFR 212.78 (1980).

APPEARANCES: George J. Domas, Esq., William M. Meyers, Esq., and Philip K. Jones, Jr., Esq., New Orleans, Louisiana, for Pennzoil Oil and Gas, Inc.; Bruce Dannemeyer, Esq., and Peter J. Schaumberg, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE IRWIN

I. Factual and Procedural Background

Pennzoil Oil & Gas, Inc. (Pennzoil), has appealed from a decision by the Acting Director, Minerals Management Service (MMS), dated April 3, 1984, requiring the payment of additional royalties of \$159,602.94 on crude oil produced from offshore lease OCS-G 2115, Eugene Island Block 330, during the period August 1980 to January 1981.

On September 24, 1981, MMS' predecessor, the Gulf of Mexico OCS Region of the Geological Survey located in Metairie, Louisiana, notified Pennzoil that royalty payments on this lease were deficient because Pennzoil had not remitted accrued royalty "on that portion of gross proceeds for sales classified as tertiary incentive revenue."

In the Energy Conservation and Production Act (ECPA) enacted in 1976, Congress directed the President to amend regulations relating to the price

of oil in order to "provide additional price incentives for bona fide tertiary enhanced recovery techniques." 1/ The Secretary of Energy, to whom this assignment was delegated, adopted a regulation that permitted a "qualified producer" to charge a price higher than the ceiling price for crude oil established under the Emergency Petroleum Allocation Act (EPAA) of 1975, 15 U.S.C. || 753(a), 757(a) (1976), to cover 75 percent of specified "recoupable allowed expenses" of qualified tertiary recovery projects. 2/ Such higher prices could be charged for crude oil produced from properties other than those involved in projects. The difference between the regulated ceiling price and the higher price was termed "tertiary incentive revenue." 3/ The crude oil produced from lease OCS-G 2115 between August 1980 and January 1981 was sold under the tertiary incentive crude oil program. 4/

"Under 30 CFR 250.64 and lease terms," the September 24, 1981, Geological Survey (GS) letter stated,

[R]oyalty is to be paid on production value. Under no circumstances shall the value of production of any product for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee. Because Pennzoil has not paid the Geological Survey the value of production, an unwarranted windfall of profit has accrued to the lessee.

Pennzoil was directed to make payment within 30 days of receipt of the letter, and told of its right to appeal to the Director of GS.

Pennzoil filed a timely notice of appeal 5/ and later a brief. The Chief of the Royalty Compliance Office in Metairie prepared a report on the

1/ P.L. 94-385, | 122, Aug. 14, 1976, 90 Stat. 1134, 15 U.S.C. | 757(j)(1) (1982). "Tertiary enhanced recovery techniques" were defined as

"extraordinary and high cost enhancement technologies of a type associated with tertiary applications including, to the extent that such techniques would be uneconomical without additional pricing incentives, miscible fluid or gas injection, chemical flooding, steam flooding, microemulsion flooding, in situ combustion, cyclic steam injection, polymer flooding, and caustic flooding and variations of the same. The President shall have authority to further define the term by rule."

15 U.S.C. | 757(j)(2) (1982). See 44 FR 51148 n.1 (Aug. 30, 1979).

2/ 10 CFR 212.78, 44 FR 18677 (Mar. 29, 1979), 44 FR 51148 (Aug. 30, 1979). See Diamond Shamrock Corp. v. Edwards, 510 F. Supp. 1376, 1381 (D. Del. 1981).

3/ 10 CFR 212.78(c), 44 FR 51154 (Aug. 30, 1979).

4/ This program was discontinued by Exec. Order No. 12287, which exempted all crude and refined petroleum products from price and allocation controls as of Jan. 28, 1981. 46 FR 9909 (Jan. 30, 1981).

5/ Pennzoil received the Sept. 21 letter on Sept. 28, 1981. It filed its notice of appeal on Oct. 27, 1981, in the Metairie, Louisiana, office of GS. 30 CFR 290.3 requires that an appeal to the Director be taken by filing a notice of appeal within 30 days of service "in the office of the official issuing the order or decision." The statement in the Acting Director's

appeal on June 30, 1982, and offered Pennzoil an opportunity to comment on it. Pennzoil's comments were filed on October 13, 1982. Pennzoil appealed the Acting Director's April 3, 1984, decision to the Board and filed a statement of reasons (SOR). MMS has filed an answer.

II. The MMS Acting Director's Decision

The Acting Director's decision stated the Emergency Petroleum Allocation Act did not by implication repeal the authority of the Secretary of the Interior under the Outer Continental Shelf Lands Act (OCSLA) to value production for royalty purposes, and that value was different from the sale price of the production. Although the Department of Energy Organization Act transferred some functions under OCSLA to the Department of Energy (DOE), 6/ section 303(a) of the former Act provided that DOE could not limit the authority retained by the Secretary of the Interior concerning the supervision of Federal leases, 7/ the Acting Director stated. That authority includes the discretionary power to prescribe royalty valuation methods, he wrote, citing Shell Oil Co., 52 IBLA 15, 20 (1981), and Supron Energy Corp., 46 IBLA 181 (1980). "It follows that DOE could not abrogate DOI's [Department of the Interior's] regulations regarding royalty determinations and could not put DOI in the position of a private royalty interest owner, as suggested by Pennzoil," the Acting Director concluded (Decision at 3).

"The determination that Pennzoil is required to pay royalties on the basis of gross proceeds accruing to the lessee is fully supported by OCSLA, the lease, and the regulations," the Acting Director continued (Decision at 3). Section 8(b)(3) of OCSLA provided that an oil and gas lease shall "require the payment of a royalty of not less than 12 1/2 per centum, in the amount or value of the production saved, removed, or sold from the lease," 8/ and the lease establishes the rate at 16-2/3 percent of the amount or value of production saved, removed, or sold. The lease specifically provides, in section 3(a)(2), that the Secretary may establish minimum values for purposes of computing royalty, "due consideration being

fn. 5 (continued)

Apr. 3, 1984, decision that Pennzoil's appeal "must * * * be dismissed as untimely" because it was not received by the Office of the Director until Nov. 3, 1981 (Decision at 5) is in error.

6/ See section 302(b), P.L. 95-91, Aug. 4, 1977, 91 Stat. 578-79, 42 U.S.C. | 7152(b) (1976). This subsection was repealed by section 201 of P.L. 97-100, Dec. 23, 1981, 95 Stat. 1407.

7/ Section 303(a), 91 Stat. 579, 42 U.S.C. | 7153(a) (1982), provides in part:

"The Secretary of the Interior shall retain any authorities not transferred under section 302(b) of this Act and shall be solely responsible for the issuance and supervision of Federal leases and the enforcement of all regulations applicable to the leasing of mineral resources, including but not limited to lease terms and conditions and production rates. No regulation promulgated by the Secretary [of Energy] shall restrict or limit any authority retained by the Secretary of the Interior under section 302(b) of this Act with respect to the issuance or supervision of Federal leases."

8/ P.L. 83-212, Aug. 7, 1953, 67 Stat. 468.

given to the * * * price received by the Lessee" (among other matters), the decision states. Further, the regulation applicable to the period August 1980 - January 1981, 30 CFR 250.64 (1980), provided:

The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

"This language [of the last sentence quoted above] has been in the regulations for a significant length of time (19 FR 2659, May 8, 1954)," the Acting Director observed, and the interpretation of OCSLA it reflects is entitled to great deference for that reason. ^{9/} In addition, since Congress did not change the language of section 8 concerning the basis for royalties when it amended OCSLA in 1978, "it may be inferred that Congress approved of 30 CFR 250.64 including the provision contemplating the collection of royalties on the basis of gross proceeds accruing to the lessee" (Decision at 4).

"Value" means "market value," the Acting Director stated, citing California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961), and, although "Pennzoil argues that gross proceeds cannot be equated with 'value' in

^{9/} As originally proposed and as promulgated, the sentence read:

"Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary."

See 19 FR 799 (Feb. 11, 1954), 19 FR 2659 (May 8, 1954).

The regulations in 30 CFR Part 250 were amended to reflect the Outer Continental Shelf Lands Act Amendments of 1978 as well as to make "changes to make Part 250 more readable as directed by Executive Order 12044 and 43 CFR Part 14." 44 FR 13527, 13528 (Mar. 12, 1979), 44 FR 61886 (Oct. 20, 1979). The change in the sentence of 30 CFR 250.64 at issue was presumably made to make it more readable; no comment concerning it was reported. 44 FR 61891 (Oct. 26, 1979). The Department subsequently redesignated the regulation as 30 CFR 206.150, effective Aug. 5, 1983. 48 FR 35641 (Aug. 5, 1983).

Effective Mar. 1, 1988, the Department significantly amended the regulations applicable to the valuation of oil and gas for royalty computation purposes. See 53 FR 1184, 1230 (Jan. 15, 1988). The regulations applicable to the valuation of oil for royalty computation purposes are currently codified at 30 CFR Part 206 (53 FR 1218 - 1225 (Jan. 15, 1988)). See 30 CFR 206.101 for the current definition of "gross proceeds" and 30 CFR 206.102(h).

this case[,] [t]o the extent that a buyer did pay to Pennzoil the price represented by such gross proceeds, we have no difficulty in equating the gross proceeds with 'value,'" the Acting Director concluded (Decision at 4). 10/

III. Appellant's Arguments on Appeal

In its SOR for appeal to the Board, Pennzoil acknowledges that royalty from OCSLA leases is based on value of production and that DOI is responsible for determining value for royalty purposes. It maintains, however, that tertiary incentive revenue is not properly regarded as part of the value of production because it corresponds to the expenses of tertiary recovery projects. 11/ Pennzoil also acknowledges the respective statutory authorities of DOE and DOI. It urges that the conflicting positions of the two departments on "the question of whether the government, as lessee [sic], is entitled to share in tertiary incentive revenue" (SOR at 6) can and should be reconciled in favor of DOE's position that it is not.

Although OCSLA (as well as the lease) provides that royalties be based on "value," the term is not defined, Pennzoil observes, and neither requires gross proceeds as a basis for royalties. In enacting the 1978 amendments to OCSLA, the Congress declared its policy that the Outer Continental Shelf should be made available for development "in a manner which is consistent with the maintenance of competition and other national needs," 43 U.S.C. | 1332(3) (1982) (emphasis added), Pennzoil points out. Oil and natural gas resources are to be protected and developed so as to "insure the public a fair and equitable return on the resources," 12/ not to maximize royalties. Only 30 CFR 250.64 states that the value of production may not be less than gross proceeds accruing to the lessee, but that language in the regulation was adopted (in 1954) before oil prices were regulated and the tertiary enhanced recovery program was not in effect when the regulation was amended (in October 1979) and the language left essentially unchanged. 13/

10/ The Acting Director's decision also observed that because section 8 of OCSLA did not refer to regulated prices, while 43 U.S.C. | 1353 (1982) does, "the treatment by DOE of cases involving royalty oil pricing is inapposite" (Decision at 4).

11/ The SOR at page 5 states:

"While in most cases gross proceeds can be equated with value for royalty purposes, it is Pennzoil's contention that where tertiary incentive revenue is allowed by the DOE to be recovered from the sale of oil from one lease in order to offset certain allowable expenses incurred in enhanced recovery projects on other leases, there is absolutely no correlation between the additional proceeds received as tertiary incentive revenue and the value as that term is used in the governing statute and in Pennzoil's lease."

12/ H.R. Rep. No. 590, 95th Cong., 1st Sess. 122, reprinted in 1977 U.S. Code Cong. & Ad. News, 1450, 1528.

13/ Although the amendment of 10 CFR 212.78 was proposed in March 1979 and became effective Oct. 1, 1979, the incentive program did not begin until Jan. 1, 1980. 10 CFR 212.78(a)(2), 44 FR 51152 (Aug. 30, 1979).

Pennzoil submits DOE Interpretation 1980-7, issued April 22, 1980, which holds that royalties on tertiary incentive crude oil should be based on the ceiling price of the oil. In that Interpretation, DOE answered the question, "On what basis are royalty interests in a property to be paid when crude oil produced from that property is sold as tertiary incentive crude oil and the owner of the royalty interest is not a 'qualified producer'?" See SOR, Exhibit 3. A "qualified producer" is defined as one who holds an interest in a property on which an enhanced oil recovery project is located and who "contributes to the initiation or expansion of the project." ^{14/} On this basis, DOE answered the question as follows:

[10 CFR] Section 212.78(a)(2) provides that the ceiling price does not apply to "first sales of crude oil by or for the behalf of a [qualified] producer" provided that "tertiary incentive revenue" from such sales does not exceed the "recoupable allowed expenses" attributable to that producer. Thus, the rule clearly provides that the producer must have "recoupable allowed expenses" attributed to it in order to be released from the applicable ceiling price. Under | 212.78(c) "recoupable allowed expenses" may be attributed only to "qualified producers." Accordingly, only the "qualified producer" may be paid in reference to the uncontrolled price for its interest in the tertiary incentive crude oil sold, provided that the "tertiary incentive revenues" received do not exceed the "recoupable allowed expenses" attributable to that producer. With respect to all other interests in the crude oil produced from the property concerned, the tertiary incentive program has no effect and the interest owners must be paid in reference to the otherwise applicable ceiling price in order to prevent the diversion of limited "tertiary incentive revenues" to royalty owners that have not invested in EOR [enhanced oil recovery] projects." ^{15/}

^{14/} 10 CFR 212.78(c), 44 FR 51153 (Aug. 30, 1979).

"The ceiling price regulations represent DOE's exercise of authority to control prices of crude oil pursuant to the Emergency Petroleum Allocation Act of 1973, as amended * * * and these regulations are amended by the tertiary incentive program only to create an incentive for investment in EOR [enhanced oil recovery] projects. * * * Reflecting the intent that the incentive program should encourage investment, the DOE adopted a definition of 'qualified producer' in | 212.78(c) which limits the term's application to a producer that contributes to the initiation or expansion of a qualified project. The DOE has consistently expressed the purpose of these amendments to the price regulations to permit recoupment of front-end expenses to offset costs associated with EOR techniques to encourage their use." DOE Interpretation at 56,757-58.

"Initiation of a project means the start of a process on a regular basis that is intended to increase crude oil production." 44 FR 51150 (Aug. 30, 1979).

^{15/} DOE Interpretation at page 56,757. The DOE Interpretation states at page 56,758:

"[T]he royalty owner [who] * * * is not a qualified producer * * * has incurred no expenses to recoup and is not the object of the incentive program. Such royalty owners do not contribute to the initiation or expansion

Pennzoil concludes that the lessor is simply not a part of the program and that its decision to recover its expenses incurred for EOR projects elsewhere from sales of oil produced from this lease was "mere happenstance" and had nothing to do with the value of that oil (SOR at 15).

Pennzoil argues that the OCSLA and the ECPA amendment of the Emergency Petroleum Allocation Act are not inconsistent; it is only the application of the regulations based on them that is. Pennzoil suggests that the provisions of the ECPA amendment calling for incentives for enhanced oil recovery projects are both later and more specific than those of OCSLA concerning the basis for royalties, so that, under rules of statutory interpretation, the apparent conflict may be resolved in favor of the DOE's implementation of its responsibility to determine prices. The legislative history of the ECPA amendment reinforces this approach, in Pennzoil's view. If the DOI regulation is applied to require payment of royalties on tertiary incentive revenue, it would frustrate a program specifically mandated by the Congress by preventing a producer who undertook an EOR project from recovering the full amount of the expenses he was entitled to recover (SOR at 15, 20).

The Acting Director's April 3, 1984, decision relies on 30 CFR 250.64, Pennzoil notes. "Pennzoil contends, however, that the regulation relied upon is itself invalid to the extent that it requires the payment of royalty based on gross proceeds where those gross proceeds include tertiary incentive revenue" (SOR at 21).

Finally, Pennzoil notes that DOI acknowledged that Kentucky Oil & Refining Company (Kentucky) was correct in arguing it should not have to pay increased charges that reflected Pennzoil's tertiary incentive revenue for oil Kentucky purchased from the Department that had been taken in kind from the Pennzoil lease involved in this case, and agreed to dismissal of Kentucky's appeal (IBLA 82-56). Although in that case DOI took its royalty in kind, rather than in value, Pennzoil refers to the Solicitor's October 21, 1977, memorandum entitled "The Secretary's power to modify his authority with regard to royalty on oil and gas to accommodate the FEA's [Federal Energy Administration's] policy objectives with regard to price regulation" that states: "the United States should receive the same royalty value whether the royalty on production is taken in kind or in value." See SOR, Exhibit 4, at 18. It would be arbitrary for the Department to treat Pennzoil differently than Kentucky, Pennzoil suggests (SOR at 28).

fn. 15 (continued)

of an EOR project and in no way increase the output of such projects. * * * Based on the clear intent of the program to offer partial recoupment of certain actual expenses as an incentive to invest in EOR projects, | 212.78(a)(2) can only be interpreted to remove the ceiling price with respect to the 'qualified producer.' Accordingly, the amendments do not modify the ceiling price with respect to such royalty interest owners, and they must continue to receive payment on the basis of the otherwise applicable ceiling price. It follows that royalty payments to royalty owners that are not 'qualified producers' may not be paid on the basis of the uncontrolled price in sales of tertiary incentive crude oil."

IV. MMS' Answer

In MMS' view, this case "stems from Pennzoil's attempts to reduce the royalty value to a value less than its gross sales receipts" (Answer at 1). MMS defines Pennzoil's gross proceeds as "the sales price paid by its purchaser" (Answer at 3). 43 U.S.C. § 1334(a) (1982) authorizes the Secretary of the Interior to prescribe rules necessary to implement OCSLA, and 30 CFR 250.64 implements section 8 of OCSLA by interpreting "value of the production saved, removed, or sold" that is subject to royalty (Answer at 4). The regulation is within the Secretary's authority and was validly promulgated, so both Pennzoil and MMS are bound by it (Answer at 6). It also establishes the "minimum values for purposes of computing royalties" authorized by section 3(a)(1) of the lease as the "gross proceeds accruing to the lessee" (Answer at 5, 7).

MMS relies on Wheless Drilling Co., 13 IBLA 21, 80 I.D. 599 (1973), in which royalties on gas were required to be paid for the regulated rate the company sold it for plus the state severance tax that was reimbursed to the company on the grounds that in computing royalties the Secretary "may properly look to the actual consideration to be received by its lessee-seller." 80 I.D. at 604. "The only type of deductions allowed from gross proceeds are those, such as transportation costs, which inflate the price of the product over its value at the wellhead," MMS asserts, citing Kerr-McGee Corp., 22 IBLA 124 (1975), and tertiary incentive revenues are not like transportation costs (Answer at 8-9 n.5).

MMS also disputes Pennzoil's suggestion that it should not pay royalties on tertiary incentive revenue because this part of its gross proceeds is used to cover expenses for EOR projects, relying on Amoco Production Co., 29 IBLA 234, 238 (1977), in which the Board rejected the argument that revenues earmarked to pay state severance taxes should not be counted as part of the value for purposes of computing royalties (Answer at 10). Nor does MMS accept Pennzoil's argument that its EOR projects were unrelated to the lease and were encouraged by DOE, and that the tertiary incentive revenue that covered part of the expenses for those projects was unrelated to the value of production from the lease.

The only inquiry is what did Pennzoil receive from the sale of the OCS oil. While the regulations permit a higher value for royalty purposes, the regulations mandate that under no circumstances can value be less than gross proceeds * * *. There is no question that the buyer paid to Pennzoil the uncontrolled price only for the oil from lease OCS G-2115. The uncontrolled price, therefore, undeniably is Pennzoil's gross proceeds from the sale of that oil irrespective of the fact that it was Pennzoil's activities on other properties which permitted it to sell the OCS oil at a higher price. [Emphasis in original.]

(Answer at 11-12).

To Pennzoil's argument that it was mere happenstance that it obtained its tertiary incentive revenue through sales of oil from this lease, MMS

responds that "Pennzoil was able to recover those revenues only because it had the Federal lease. Since Pennzoil benefitted from production from that lease, the 'gross proceeds' rule means that the Federal Government is entitled to its royalty share based upon the full extent of that benefit" (Answer at 12).

MMS argues that OCSLA's delegation of authority to the Secretary of the Interior to promulgate rules to implement the statute is more specific than the authority delegated to the President in the ECPA amendment to the EPAA to "provide additional price incentives for bona fide tertiary enhanced recovery techniques" because OCSLA deals with value for royalty purposes, not prices, and this case involves value for royalty purposes. Further, "DOE regulations and other administrative pronouncements issued under its general pricing authority cannot limit DOI's statutory authority to determine value for royalty purposes. Only Congress can repeal or amend that authority, and neither the EPAA nor ECPA expressly does so. Furthermore, repeals by implication are not favored" (Answer at 15-16).

MMS explains that it decided not to contest the appeal of Kentucky because of DOE's authority over first sales of crude oil. However, "DOE's authority to regulate the sales price of a commodity does not authorize it to limit the royalty value of that commodity as established by DOI" (Answer at 14 n.6). MMS rejects Pennzoil's suggestion that DOI cannot receive a higher royalty from Pennzoil than it can ask as a price for Pennzoil's royalty oil on the same grounds, *i.e.*, that DOI's authority to determine value for royalty purposes is distinct from DOE's to determine prices. *Id.*

MMS argues that Congress re-affirmed DOI's supremacy in determining value when it deleted section 11 of the Administration's version of the proposed Federal Oil and Gas Royalty Management Act, which provided that the "Secretary shall include gross proceeds received from the sale of production of any mineral resource from any lease on the Outer Continental Shelf * * * in valuing production for royalty purposes, notwithstanding any incentives or regulated price relief * * * granted to the producer by a regulatory agency" (Answer at 16-17, and Exh. C). MMS argues that the deletion is evidence that Congress believed the provision to be necessary because existing law established the dominance of DOI in valuation matters.

MMS relies on Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983), *cert. denied*, 469 U.S. 821 (1984), which affirmed the Board's decision in Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981). The court's decision "is significant here for two reasons," MMS states.

First, it stands for the proposition that value is calculated on the basis of the total consideration accruing to the producer-seller (*i.e.*, gross proceeds). Second, it confirms the principle that a pricing statute does not restrict DOI's authority to establish a value for royalty purposes in excess of the price at which the commodity may be sold under that pricing statute.

(Answer at 18).

Finally, MMS argues, sections 1 and 3 of Pennzoil's lease require it to pay royalties based on the value of production, as determined by the Secretary. "Pennzoil is producing, selling and enjoying the benefit of a public resource," MMS concludes. "Notwithstanding the reason why Pennzoil was able to sell the oil at uncontrolled prices, it must be required to abide by its contractual and regulatory obligations and pay royalties based upon its gross proceeds" (Answer at 19).

V. "Gross Proceeds" Properly Includes Tertiary Incentive Revenue

[1] After careful consideration of the parties' arguments and review of the relevant authorities, we are persuaded that MMS properly included Pennzoil's tertiary incentive revenue within the gross proceeds that represent the value of production from this lease.

In Kerr-McGee Oil Industries, Inc., 70 I.D. 464 (1963), the Department rejected the companies' argument that a reimbursement to them by their buyer for the additional royalty they would owe for severance tax under section 6(a)(9) of OCSLA, 43 U.S.C. | 1335(a)(9) (1982), was not part of the price they received for the gas and therefore not part of value for the computation of royalty.

[W]e cannot accept the assumption upon which appellants have based all of their contentions, namely, that the value received for the gas is limited to the amount which they stipulated in their contracts with the buyers to be the contract price, and that this Department can look no further to ascertain whether other payments to be made to the seller actually represent consideration for the gas also

the Assistant Solicitor wrote. 70 I.D. at 469. The decision quoted 30 CFR 250.64, highlighting the provision involved in this case, i.e., that under no circumstances would value of production for purposes of computing royalty be deemed to be less than gross proceeds accruing to the lessee, and stated:

To say that the reimbursement for the additional royalty is not part of the "gross proceeds" to be received under their contracts would not be realistic, for if there were no reimbursement provision the lessee would still have to pay the additional royalty, taking it out of their working interest share of the production. With the reimbursement provision they are receiving an additional compensation for the production from their leases. The practical result of appellants' contentions would be that they, rather than the United States, could determine the value of production simply by allocating the value they will receive under different categories designated as being other than the "price," yet all relating to the production. There is nothing in the act or its legislative history which would suggest that this was intended.

70 I.D. at 470. The decision concluded that "the determination by the Geological Survey that the reimbursement for the additional royalty is part of the gross proceeds for the sale of the gas is reasonable and proper." Id. at 471-72.

In Wheless Drilling Co., *supra*, the lessee was obligated by its noncompetitive oil and gas lease to pay royalty on the value of production removed or sold from the leased lands, computed in accordance with 30 CFR 221.47. That regulation, adopted in 1942 under the Mineral Leasing Act, was evidently the precursor of the original 30 CFR 250.64, for it contained the same language, including the sentence concerning gross proceeds. ^{16/} Wheless Drilling Company sold gas at prices approved by the Federal Power Commission to a buyer who also reimbursed Wheless for a part of the severance tax Wheless paid to the State of Louisiana. The Board affirmed the decision of the Director of GS that royalty be paid on the basis of the sale price of the gas and the tax reimbursement made by the buyer, stating:

We recognize that authority to set field prices for natural gas sold in interstate commerce is vested in the Federal Power Commission, by the Natural Gas Act, 15 U.S.C. || 717 *et seq.* (1970). We recognize also that the field price established by FPC is not necessarily the "value of production" as that term is used in the oil and gas operating regulations, 30 CFR 221.47, especially when the additional factor of "gross proceeds" is considered.

Proceeds and fair market value may not be interchangeable. Proceeds of a sale, unless there is something in the context showing to the contrary, means total proceeds. United States v. Stanolind Crude Oil Purchasing Company, 113 F.2d 194, 198 (10th Cir. 1940).

13 IBLA at 29-30, 80 I.D. at 603.

The Board held that

[w]ithin the context of 30 CFR 221.47, "gross proceeds" means the established field price for the natural gas plus any additional sums paid by the purchaser of the gas to the unit operator as consideration for the purchase of gas from the unit of which the federal lease is a part.

Id. at 30-31, 80 I.D. at 603. It stated it was applying the principles of California Co. v. Udall, 296 F. 2d 384 (D.C. Cir. 1961), that the Secretary

^{16/} 30 CFR 221.47 (1970), adopted June 2, 1942, 7 FR 4132, provides in part:

"The value of production, for the purpose of computing royalty shall be the estimated reasonable value of the product as determined by the supervisor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary."

may establish reasonable values for royalty purposes, ^{17/} and of Kerr-McGee Oil Industries, Inc., *supra*, that the Secretary "in computing the basic royalty due to the United States under a lease may properly look to the actual consideration to be received by its lessee-seller under gas sales contracts with a buyer in order to determine the proper value basis for the royalty." *Id.* at 31, 80 I.D. at 604. ^{18/}

In Hoover & Bracken Energies, Inc., 52 IBLA 27, 88 I.D. 7 (1981), the Board held the producer responsible under 30 CFR 221.47 for payment of royalty based on the price it received from its purchaser plus the amounts of a gross production tax and an excise tax paid by the purchaser to the State of Oklahoma. The Board recognized that because the purchaser paid the taxes, "the amount of the taxes does not result in 'proceeds' as that term was used in Wheless and is ordinarily understood." 52 IBLA at 35, 88 I.D. at 11. Nevertheless, the Board found "that appellant has the same ultimate responsibility for the taxes and receives the same benefit under Oklahoma's method of tax collection as it would in a state where the seller is obligated to pay the taxes directly and benefits from reimbursement by the purchaser. Here appellant still receives the benefit of 'tax reimbursement' and consequently the value of that benefit may be added to the amount appellant receives to determine the value of production to appellant for the purpose of computing the royalty." *Id.*

The Board also concluded that the price appellant received under the Natural Gas Policy Act of 1978, 15 U.S.C. | 3320(a) (1982), was no different than the price set by the Federal Power Commission in Wheless. 52 IBLA at 34, 88 I.D. at 10.

The Board's decision in Hoover & Bracken Energies, Inc., *supra*, was affirmed by the U.S. Court of Appeals for the Tenth Circuit. Hoover & Bracken Energies, Inc. v. United States Department of the Interior, *supra*. The court noted:

It is apparent that Wheless is a persuasive authority. While it does not control this court's decision, the decision so made has been in effect for ten years and has been utilized by lessees and lessors for the past ten years. The enactment of the NGPA [Natural Gas Policy Act of 1978] does not affect the soundness of the reasoning present in Wheless.

723 F.2d at 1493.

^{17/} In this case the Secretary's determination that royalties were to be based on the price paid the company for the gas, without any deduction for its costs of removing excess water and hydrocarbons from the gas and compressing it for pipeline transmission, was upheld. See The California Co., 66 I.D. 54 (1959).

^{18/} Wheless was followed in Knife River Coal Mining Co., 29 IBLA 26 (1977); Amoco Production Co., 29 IBLA 234 (1977); Tricentrol United States, Inc., 105 IBLA 392 (1988); and Enron Corp., 106 IBLA 394 (1989).

We find these cases persuasive. Like 30 CFR 221.47 for the Mineral Leasing Act, 30 CFR 250.64 is a reasonable interpretation of the value of production under OCSLA. See Amoco Production Co., 29 IBLA 234, 236 (1977); Texaco, Inc., 104 IBLA 304, 308 (1988). That regulation directs that there are no circumstances under which value of production may be less than the gross proceeds accruing to the lessee, and we are not free to declare the regulation invalid. Western Slope Carbon, Inc., 98 IBLA 198, 201 (1987); Chugach Natives, Inc., 80 IBLA 89, 94 (1984). Gross proceeds looks to the actual consideration received for the oil produced from the lease. Wheless Drilling Co., 13 IBLA at 31, 80 I.D. at 604. In this case that included Pennzoil's tertiary incentive revenue. The ceiling price established by DOE is different from the value of production established by DOI. Id. at 29, 80 I.D. at 603. DOE's interpretation of 10 CFR 212.78 cannot negate the basis established by the Department of the Interior in 30 CFR 250.64 for determining the value of production any more than a lessee can by declaring what the price of the resource is. Kerr-McGee Industries, Inc., supra at 470.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the Acting Director's April 3, 1984, decision is affirmed.

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Will A. Irwin
Administrative Judge

I concur:

Bruce R. Harris
Administrative Judge